Allstate Insurance Company's Additional Written Testimony
July 23, 2002

ALLSTATE'S USE OF INSURANCE SCORING

Allstate's use of insurance scoring is premised on the principle that those less likely to incur losses should pay less for insurance. We have found insurance scoring is an extremely powerful loss predictor, and that it provides predictive power beyond what we can achieve with other single risk evaluation variables.

By using insurance scoring to provide discounts in Michigan, we have been able to reduce subsidies among the business we write, rewarding customers less likely to incur losses with discounts based on their group's prospective loss costs.

Insurance scoring has had a positive effect on Michigan consumers. More than half of Allstate's customers in Michigan are paying less for insurance because of discounts based on insurance score. These customers deserve these discounts because they have a lower risk of loss. In addition, a marketplace with a wide range of pricing practices promotes competition and offers the consumer a range of prices from which to choose. It is to consumers' benefit that not all companies use the same scoring model, and that some companies choose not to use insurance scoring.

Allstate uses information that comes from credit reports for purposes of determining the likelihood of an insured to incur an insurance loss. We do not use insurance scores to assess ability to repay an obligation or credit worthiness. Rather, we use insurance scores to further increase the accuracy of our risk evaluation. We use insurance scoring in addition to, not instead of, our other risk evaluation tools. In fact, someone turned down for a credit card or a bank loan could qualify for our biggest discount based on his or her insurance score. We do not ask for, look at, or consider personal income.

In addition to not considering income, Allstate's scoring methodology **does not consider:**

1) Ethnic group
2) Religion
3) Gender
4) Familiar status
5) Handicap
6) Nationality
7) Age
8) Marital Status
9) Address

Allstate's scoring model **does consider** five types of information contained in a credit report:

- Credit Performance (e.g. delinquencies, bankruptcies)
- Account Vintage (e.g. length of account history)
- Account Diversity (e.g. the presence of various types of accounts)
- Credit Utilization (e.g. balance to limit *ratios*)
- Credit Seeking Activity (e.g. non-promotional inquiries, excluding insurance inquiries)

We have found these types of information are very predictive of loss performance. Each of the characteristics Allstate uses, independent from one another, has statistically demonstrated a high correlation of insurance loss predictability. When used in combination with one another, our data strongly supports what other insurers and providers of insurance scoring have found, i.e., insurance scoring is a powerful indicator of groups of people that are more likely to incur losses. Similar types of information have been used in the financial services industry for many years.

CORRELATION BETWEEN CREDIT HISTORY AND RISK OF LOSS

Allstate's actual experience confirms insurance scoring, based on credit history, is a very strong predictor of loss. In addition, several industry studies have been performed that conclude likewise.

The tables below demonstrate just how powerful insurance scoring is as a predictor of loss for Allstate insureds. They show loss ratio relativities by Insurance Financial Stability (IFS) Group based on Allstate countrywide data.

Standard Auto

IFS Group	Loss Ratio Relativity
1	83
2	91
3	103
4	118
5	136
Total	100

Homeowners

IFS Group	Loss Ratio Relativity
1	67
2	90
3	122
4	167
5	244
Total	100

NO-HITS

Allstate defines a "No Hit" as any one of the following:

1. **No Hit because no credit file matches** the name and address supplied by the consumer. With the information supplied by the consumer (e.g. name and last known addresses) the Credit Bureau could not find a matching file. Social security numbers are not a primary index but serve as a secondary check.
2. **No Hit because of Edit Errors**. Edit Errors result from submission of illogical information (invalid zip code, bad or illogical address, missing address information, etc.). Edit errors will prevent the system from attempting a search, therefore, edit errors are returned as a No Hit.
3. N**o Hit because a file is located but insufficient data is** on file to generate an insurance score. Any credit records returned with only a header record (consumer indicative info - name, address, social security number, date of birth, etc.) and an inquiry record section are considered "No Hits." Records in this third category are sometimes referred to as "thin files."

It is important to note that a credit report on which there are accounts present, but on which there has been no activity recently, is not a "thin file." These files are treated just like files with recent activity – an insurance score is calculated. When a credit report is not available, or when a credit file consists only of inquiries, we cannot calculate an insurance score. We therefore assign a score that is commensurate with the loss experience that we have observed for no-hits as a group.
In determining an appropriate score to assign to no-hits, we evaluate experience separately by line of insurance. For example, the performance of no-hits for property insurance is more favorable than for automobile insurance. We have found no-hits do have significantly worse than average loss experience for automobile insurance, and so a higher than average score is assigned when a credit report is not available. We have also evaluated the loss experience of no-hits by age, and as a result of this analysis treat no-hits under age 19 and over age 64 more favorably than those in the 19-64-age category. If we did not consider the loss experience of the group with no credit history, consumers who we know are less likely to incur losses would have to pay more to subsidize consumers who we know are more likely to incur losses.

INQUIRIES

Allstate **does not consider** insurance inquiries, promotional inquiries/hits (when 3rd parties access an individual's credit report for purpose of updating or offering credit), or inquiries resulting from consumer requests to see their own credit. However, Allstate **does consider** inquiries/hits the consumer initiates for purposes of gaining or using credit. Allstate's model gives special consideration to inquiries of a similar nature, e.g., multiple bank loan inquiries that may be the result of shopping for a favorable mortgage rate. Our scoring model will consider multiple inquiries of a similar nature, occurring close together, as one inquiry in the score calculation. However, each inquiry related to credit card or department store cards will be considered

Allstate considers hits (inquiries) over the past two years in its assessment of risk because they are very predictive of insurance losses. The table below clearly demonstrates that as a group, those with more inquiries have higher losses. To ignore this data and exclude inquiries would cause customers who have demonstrated lower loss potential to pay more than they otherwise would pay.

# of Inquiries	% of Policies	Loss Ratio Relativity
0	43%	92
1	20%	97
2	12%	100
3	7%	103
4	5%	108
5+	12%	119

CREDIT REPORT ACCURACY

Mortgage lenders, banks and brokerages, in fact the heart and soul of our economy, depend and rely upon credit reports for decision-making with regard to consumer lending. Three major credit bureaus collect and provide credit data for insurers and other business entities. According to testimony given by the Consumer Data Association (CDIA) at OFIS's July 11 hearing, over two million requests for consumer credit reports are provided by these companies on a daily basis. The Federal Trade Commission regulates these companies and the FCRA governs the requirements, which safeguard the consumer. There is tremendous pressure on consumer reporting agencies to ensure the accuracy of their reports. Companies lending money based on the data they receive must be able to depend on it. Sanctions under the FCRA allow for financial penalties for improper reporting or collection of data.

In 2001, Allstate ordered over 17 million credit reports. The number of written requests from consumers disputing information on their credit report totaled less then 3,000, or .017 percent of the total number of reports ordered. Of that small number, only some of the disputes were legitimate. Of the number of legitimate disputes, only some would have any bearing on the insurance score because we only look at certain characteristics. Of the number affecting the insurance score, only some would affect the discount amount because the score must change by a certain amount to move into another discount category. Thus, the number of inaccurate credit reports that affect the premium charged is at most a subset of a subset of a subset of .017 percent.

At Allstate we are nevertheless very concerned about errors in credit reports. Accurate information is essential to proper risk evaluation. If a consumer does not get our very best discount because of their credit score, we notify the consumer. Further, the consumer is entitled to a free copy of their credit report for review in order to correct any errors on said report. We provide the name, address and phone number of the reporting agency from which we received the report and from which the applicant can obtain a free copy of his or her report.

An applicant who thinks there has been a mistake may order the report and see an incident he or she had forgotten about. But mistakes do happen, and if the applicant discovers a mistake, there is a procedure to follow that is governed by the FCRA. According to the testimony given by the CDA, many of the errors reported by consumers are small errors, i.e., middle initial lacking, etc., which will have little or no impact on a person's score. The FCRA provides the credit bureau must investigate and respond to the request to correct within 30 days. If a response is not received in a timely fashion, then the law provides the disputed item will be removed.

If a consumer corrects a mistake in their credit report and notifies us of the same, we will re-run their credit report to determine if the correction would change their score sufficiently to alter their discount. If the discount is favorably changed, we will adjust the premium back to the date it originated. If we reorder because a consumer has corrected information, but the score gets worse, we do not apply the new score -- the customer continues to be rated using the old score. It is only if the score improves that we make a change.

We have a substantial stake in the accuracy of credit reports because, in the fiercely competitive insurance market, we cannot afford to turn away good risks or charge uncompetitive premiums.

CUSTOMER COMMUNICATION

It is Allstate's company policy to inform consumers of our intentions to order their credit report, before we order it, for any new insurance application or quote. There is no Federal or Michigan law that requires us to so inform the consumer, however, we have established this policy for what we consider good business practices. In addition, our processes require that customers who do not receive Allstate's largest discount based on information contained in their credit report be notified of this and informed of how they can obtain free copy of their credit report.
Allstate's annual notice of rating systems also includes information on the use of credit history.

Also, Allstate has made available a consumer brochure that explains our use of credit history. This brochure is available at www. Allstate.com and explains:

- Why Allstate uses credit information
- How Allstate's use of credit differs from that of a mortgage company
- What kind of credit information Allstate uses and how it is used
- What type of credit information is generally associated with better scores
- How credit card usage affects scores
- The relationship between credit history and the likelihood of having insurance losses.

Allstate's agents play a vital role in our communication to our customers. They are expected to inform customers whose credit reports will be ordered and for what purpose, and to answer general questions about our use of credit reports. We have provided agents with in-person education, an agency support document, statements of the company's position on the use of credit reports, and a brochure they can share with consumers. We continue to look for ways to provide more useful information to agents and customers. It is critical to our company's success and our customers' satisfaction that our agents are well informed and able to speak to our use of insurance scoring.

IS THERE AN INTUITIVE LIKE BETWEEN INSURANCE SCORES AND INSURANCE LOSSES?

Allstate decides whether an applicant qualifies for insurance based on a variety of factors. Experience shows these factors help predict the likelihood of loss. For example, we underwrite against traffic violations only because our data shows the group of people with speeding tickets in the past tend to have more losses in the future. The same type of analysis shows that people within the bottom 10% of auto insurance scores are about 60% more likely to incur losses than others. That analysis has been validated by the actual experience of millions of auto exposures. We would be irresponsible to ignore it.

A physicist probably could explain why a Tiger Woods' putt is so likely to go in, but for Tiger Woods, the "why" is not nearly as important as the "is." What is important is the shot does go in. For Allstate what is important is the fact that insurance scores predict loss. The theories presented below are persuasive, but the "fact" of insurance scoring's predictive power, not the reason for its predictive power, is the basis for Allstate's use of this important tool.

The link between credit history and loss potential has been studied extensively by many scholars independent of the insurance industry in fields such as psychology, safety engineering, occupational medicine, consumer research, and risk perception. Over 30 articles and studies we analyzed point to two basic explanations.

The first explanation relates to stress. People under stress are more likely to have auto accidents. They may be more easily distracted or not react as well to certain situations

(The difference between an accident and a near-miss is often just a few seconds). Financial problems are a known cause of stress. Therefore, some people with poor scores are more likely to experience stress and thus more likely to incur losses.

The second explanation relates to risk-taking behavior. Different people have different aversions to risk. Some people like to skydive. Some people are afraid of the amusement park roller coaster. Some people will run a yellow light if it was yellow when they first saw it. Some people will stay under 55 on the highway. People who are more likely to take risks are more likely to get into serious financial difficulties (bankruptcies, liens, foreclosures, etc.) than those who are more risk averse. People who are more likely to take risks are also more likely to get into auto accidents. Therefore, some people with poor scores are more likely to engage in risky behavior and thus more likely to incur losses.

Either or both of these theories may be true for a particular individual. In some instances, financial difficulties might not be caused by risk-taking behavior but will still produce stress. In other instances, however, it is the risk-taking behavior rather than stress that leads to a greater likelihood of loss.

Allstate's use of insurance scoring as an underwriting factor is based on the fact of its predictive power, not the explanation for its predictive power. Just as it would be foolish to ignore the fact that apples fall down from trees because scientists have yet to fully explain how gravity works, we would be foolish to ignore (nor would our customers receiving discounts want us to ignore) the fact of the predictive power of insurance scoring. Nevertheless, we take great comfort that support for the link between credit history and loss potential exists in the academic literature and is intuitively satisfying.